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No. 10-711

Supreme Court, U.S.
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IN THE

Supreme Court of the United States

NATIONAL UNION FIRE INSURANCE COMPANY OF PITTSBURGH, PA,

Petitioner,

v.

VP BUILDINGS, INC.,

Respondent.

ON PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SIXTH CIRCUIT

PETITIONER'S REPLY IN SUPPORT OF PETITION FOR CERTIORARI

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RULE 29.6 STATEMENT

Petitioner's Corporate Disclosure Statement was set forth at page *ii* of its Petition for Writ of Certiorari, and there are no amendments to that Statement.

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REPLY BRIEF FOR PETITIONER

The VP Debtors contend that this case is about (1) "forc[ing]" a debtor to reimburse a creditor for amounts the creditor "may never pay," Op. 6, and (2) "rescu[ing]" the creditor from "its own miscalculations" because, at the time the debtor agreed to pay for its insurance, the creditor did not insist on enough collateral to back up the debtor's payment obligation, *id.* 1, 3-4. These assertions are nonsense. Rejecting them, Circuit Judges Cook and White observed in their concurrence that this case is actually about the VP Debtors receiving a "windfall" by "avoiding the entire post-confirmation portion of the obligation" they owe. Pet. App. 14a. As the concurring judges also determined, the VP Debtors accomplish this by invoking an incorrect standard of law governing the determination of administrative expenses that (1) conflicts with the decisions of other courts of appeals, (2) conflicts with a prior decision of this Court, and (3) portends grave consequences for the administration of chapter 11 cases. *Id.* 15a-18a. For the reasons actually addressed below, the Court should grant certiorari.

The VP Debtors' contention that this case is about inadequate collateral is obviously wrong and irrelevant. It is axiomatic that a creditor takes collateral to secure an obligation of some kind (*i.e.*, the very idea of collateral is that it se-

cures *something*). U.C.C. § 9-102(a)(12) (2010) ("'Collateral' means the property subject to a security interest"); *id.* § 1-201(b)(35) ("'Security interest' means an interest in personal property or fixtures which secures payment or performance of an obligation."). Conversely, whether a creditor takes collateral or not has nothing to do with the validity of the underlying obligation. For example, if the creditor takes zero collateral to secure an obligation, that does not mean the obligation is invalid. It simply means the obligation is unsecured. Likewise, if the creditor takes collateral, but the value of the collateral is less than the full amount of the obligation owed, that also does not mean the obligation is invalid. It simply means the obligation is inadequately secured. As the Court below properly recognized, this case is not about whether National Union took adequate collateral, but rather whether the VP Debtors had a payment obligation in the first instance that is entitled to administrative priority. Accordingly, the VP Debtor's specious collateralization assertion played no part in the decision below.

Likewise, the VP Debtors' contention that this case is about forcing a debtor to pay amounts the creditor may not have to pay is an equally irrelevant deflection. The unpaid amounts have been liquidated through arbitration, Pet. App. 33a-34a, and the VP Debtors simply wish to avoid paying them. As the court be-

low properly recognized, what matters in this case is the legal basis for the VP Debtors' assertion that they do not have to pay. As noted, the legal basis consists of an erroneous rule of law that conflicts with the decisions of other courts of appeals and a prior decision of this Court with dire consequences for the administration of chapter 11 proceedings. Certiorari is warranted.

I. The Circuits Are Divided Over the Question Presented.

It is undisputed that the VP Debtors were required to obtain workers' compensation insurance. Op. 1. Petitioner, National Union, provided the insurance, and in 2001 (during the post-petition and pre-confirmation reorganization period), the VP Debtors obligated themselves to pay the full cost of that insurance. USDC App. I-A39, II-A173-74, 195-96. The VP Debtors argue (and the Sixth Circuit was bound by its prior precedent in *HNRC*[1] to hold) that the deductible reimbursement portion of the cost of this insurance is not an "actual" expense because the amount ultimately due was not fixed at the time of plan confirmation. Op. 9; Pet. App. 12a. National Union contends, following the standard adopted by other courts of appeals and urged by the concurrence below, that the "actual, neces-

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[1] *Zurich Am. Ins. Co. v. Lexington Coal Co. (In re HNRC Dissolution Co.)*, 536 F.3d 683 (6th Cir. 2008).

sary" administrative expense inquiry must "focus[] not on when a creditor bills the debtor for its services, but on either: 1) when the debtor obligates itself to pay or 2) when the service is rendered," and grant administrative priority to incurred but unliquidated expenses. Pet. App. 15a-16a (Cook, J,, concurring); *see also Potter v. CNA Ins. Cos. (In re MEI Diversified, Inc.)*, 106 F.3d 829, 832 (8th Cir. 1997); *Juniper Dev. Group v. Kahn (In re Hemingway Transp., Inc.)*, 993 F.2d 915, 934 (1st Cir. 1993); *cf. Advanced Telecomm. Network, Inc. v. Allen (In re Advanced Telecomm. Network, Inc.)*, 490 F.3d 1325, 1335 (11th Cir. 2007). Certiorari is warranted precisely because the Sixth Circuit's firmly entrenched position conflicts with the decisions of other courts of appeals over the question presented.

Urging a factual characterization that the court below did not accept and that is contrary to the record, the VP Debtors attempt to obscure the analysis by advancing an incorrect understanding of when their obligation was incurred. Op. 18. To clarify, the VP Debtors incurred their obligation to pay for their insurance, including all premium and deductible obligations, when they purchased it in 2001. The Payment Agreement expressly provides that the VP Debtors agreed to pay National Union all of its "Payment Obligation," a defined term that included "Deductible Loss Reimbursements," including "any

portions thereof *not yet due and payable*." USDC App. I-A39, II-A173-74, 195-96 (emphasis added). The fact that the deductible obligations were to be paid over time does not mean they were *incurred* later; it simply means they were *due* later.

The consideration National Union provided in exchange for the administrative claim it seeks was the provision of insurance to the VP Debtors during the post-petition and pre-confirmation period. As part of that consideration, National Union assumed the obligation to advance money on behalf of the VP Debtors. Op. 17 ("[National Union] promised to advance VP Debtors' deductible obligations to injured workers and then to seek reimbursement for those deductibles."). National Union assumed that obligation upon accepting the policy, *i.e.*, post-petition and pre-confirmation. Likewise, the VP Debtors assumed the obligation to reimburse National Union when they signed the policy, also post-petition and pre-confirmation. The obligations of the parties relate to injuries sustained by the VP Debtors' employees only during the post-petition and pre-confirmation period. Notably, if the VP Debtors had not obtained workers' compensation insurance, the VP Debtors would have been liable in tort to pay benefits to employees for their work-related injuries during this period. Further, the injured employees would have been entitled to have their claims paid in full as admin-

istrative expenses. There is no reason why, having paid the claims on the VP Debtors' behalf, National Union is any less entitled to payment as an administrative expense.

It is legally irrelevant that National Union was required to fulfill its obligation over time. Upon agreeing to the Program of insurance, both National Union and the VP Debtors fixed their obligations with respect to each other, as well as the injured employees, and those obligations were simply unliquidated in part at the time of plan confirmation. As Circuit Judges Cook and White acknowledged, under the approach adopted by other circuits, this arrangement would afford National Union administrative expense priority for the Deductible Loss Reimbursement obligations at issue. Pet. App. 15a-16a (Cook, J., concurring); *see also MEI*, 106 F.3d at 832; *Hemingway*, 993 F.2d at 934; *cf. Advanced Telecomm.*, 490 F.3d at 1335. The decision of the court below, bound to follow its own prior precedent, denies administrative expense priority and thereby conflicts with the decisions of other courts of appeals. Nothing in the VP Debtors' Brief in Opposition demonstrates otherwise, and certiorari is warranted.

The conflict with the decisions of other courts of appeals is cemented by the fact that, following *HNRC*, the decision below focused on whether National Union's claim itself (a *cost*)

provided an actual and necessary benefit to the estate. National Union contends, and the concurrence and other courts of appeals have concluded, that the proper approach focuses on whether the *consideration* an estate receives in exchange for its obligation to pay confers a benefit on the estate, not whether the estate's ultimate subsequent *payment* for that consideration does so. *See* Pet. App. 13a-14a, 16a (Cook, J., concurring); *Supplee v. Bethlehem Steel Corp. (In re Bethlehem Steel Corp.)*, 479 F.3d 167, 172 (2d Cir. 2007); *CIT Commc'ns Fin. Corp. v. Midway Airlines Corp. (In re Midway Airlines Corp.)*, 406 F.3d 229, 237 (4th Cir. 2005); *Isaac v. Temex Energy, Inc. (In re Amarex, Inc.)*, 853 F.2d 1526, 1530 (10th Cir. 1988); *Cramer v. Mammoth Mart, Inc. (In re Mammoth Mart, Inc.)*, 536 F.2d 950, 954 (1st Cir. 1976). At bottom, the VP Debtors' focus on the timing of when payment is due is nothing more than a reformulation of its mistaken focus on whether the *payment* subsequently owed will benefit the bankruptcy estate, rather than the service provided.

The VP Debtors seek to deflect the Petition by focusing on whether National Union could have obtained more collateral, claiming National Union is "ask[ing] the bankruptcy court to re-

write the terms of [their] contract." Op. 9.[2] This argument is absurd. The amount of collateral was not relevant to either the decision below or the decisions of other courts of appeals cited above. That is because, as noted, the relevant question is whether National Union is entitled to an administrative expense claim in the first place, not whether that claim is secured, partially secured, or unsecured. Until *HNRC* announced its novel (and erroneous) rule that the panel below was bound to follow, National Union's administrative expense entitlement was settled. Contrary to the VP Debtors' assertions, the only way for a creditor to protect itself in the Sixth Circuit under the new regime is for the creditor to demand full up-front payment before providing any services. That, of course, would be disastrous for chapter 11 reorganization practice and is patently not the law. Certiorari is warranted.

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[2] In reality, it is the VP Debtors that seek to rewrite the terms of their contract. They seek to excise their express agreement to pay for obligations "not yet due and payable." USDC App. I-A39, II-A173-74, 195-96. Additionally, though they expressly agreed to permit the liquidation of their payment obligation by arbitration, and their obligation has been so liquidated, they now seek to avoid the results of that arbitration and suggest the amounts owed remain speculative. Pet. App. 33a-34a; USDC App. II-A179-80.

II. The Decision Below Conflicts with this Court's Precedent.

This Court has clearly instructed that "the cost of insurance against tort claims arising during an arrangement is an administrative expense payable *in full* . . . before dividends to general creditors." *Reading Co. v. Brown*, 391 U.S. 471, 483 (1968) (emphasis added). The Deductible Loss Reimbursement obligations that the VP Debtors owe to National Union are an integral part of the cost of the state-mandated workers' compensation insurance that National Union provided. USDC App. I-A39, II-A173-74, 195-96. The decision below ignored this Court's clear instruction in *Reading* and instead stripped National Union of administrative expense priority. Pet. App. 12a.

The VP Debtors attempt to distinguish *Reading* on the basis that the damages in that case were "entirely post-petition, not post-confirmation." Op. 20-21. But that is not a distinguishing factor. As explained above, the VP Debtors explicitly agreed to pay the disputed amounts when they purchased the insurance in 2001, USDC App. I-A39, II-A-173-74, 195-96, and the fact that reimbursement payments were not due until later does not change the analysis. The Deductible Loss Reimbursement obligations are part of the cost for the workers' compensation insurance National Union provided, and *Reading* demands that administrative priority

attach to the *full* cost of that insurance. *See Reading*, 391 U.S. at 483.

The VP Debtors further attempt to distinguish *Reading* on the theory that the costs and expenses in that case were somehow more "actual" than in this case. Op. 21. But in *Reading*, the creditor's administrative claim must have been estimated because its claim for $559,730.83 for the loss of the building came only three months after the fire in question, and that time period was obviously too short to know precisely what the costs of reconstructing or replacing the building would be. *Id.* at 473. Moreover, it was one of 147 claims. *Id.* In any event, the Bankruptcy Code itself expressly defines "claim" to include unliquidated and contingent amounts, 11 U.S.C. § 101(5), and bankruptcy courts have ample authority to estimate claims for purposes of allowance and payment. *E.g.*, *id.* § 502(c).

Further undercutting the VP Debtors' contention that National Union's administrative expense claim is somehow speculative, the claim has been reduced through arbitration to a fixed sum that includes all amounts owing and leaves nothing for the bankruptcy court to estimate. Pet. App. 33a-34a. More important, the VP Debtors "actually" (*i.e.*, legally) incurred their payment obligations when they purchased the insurance, and the obligations relate only to injuries that occurred during the post-petition and

pre-confirmation reorganization period. Knowing that some administrative priority claims were unliquidated, the VP Debtors' Plan expressly established a Priority Claims Trust Account to pay unresolved administrative and other priority claims post-confirmation, USDC App. II-A-110, 118, and the accounts have sufficient reserved funds to pay in full National Union's claim. The VP Debtors simply wish to avoid paying National Union and divert this money for other purposes.

The VP Debtors contend that this Court's use of the words "potentially payable in full" in *Reading* was somehow meant to suggest that some of the cost of insurance would not be afforded administrative expense priority – in this case the Deductible Loss Reimbursement obligations. Op. 24-25. The use of the word "potentially" in *Reading*, however, was simply an acknowledgement that in some cases there may not be enough assets in the debtor's bankruptcy estate to pay all administrative claims in full, as happened in *Reading* itself. *Reading*, 391 U.S. at 473, 483. In this case, National Union's administrative expense claim has been liquidated by arbitration to a fixed sum, and the VP Debtors' Plan has set aside sufficient funds to pay that claim. Pet. App. 33a-34a; USDC App. II-A110, 118. Accordingly, that concern is not relevant here.

Continuing to disregard the logic and language of *Reading*, the VP Debtors contend that the full cost of insurance should not be paid as an administrative expense because the parties might have negotiated some kind of full payment treatment in the VP Debtors' Plan. Op. 27. This gesture, however, is entirely empty. No debtor will simply give away full payment in its plan. Either the creditor has a legal entitlement to full payment (and can therefore insist on it), or it does not. *Reading* establishes that National Union does have such an entitlement. In this case, the Plan provides that administrative claims are to be paid in full, and funds have been reserved to cover National Union's claim. Nothing more is required.

The VP Debtors otherwise contend in cryptic fashion that the treatment of National Union's claim might occupy some other status, but the Court in *Reading* rejected that same suggestion. *See Reading*, 391 U.S. at 479. Once again, the Deductible Loss Reimbursement obligations for which National Union seeks administrative priority are an integral part of the cost of the insurance it extended to the VP Debtors during their reorganization. The direct conflict between the decision below and *Reading* calls for certiorari review.

III. The Question Presented Is of Exceptional Importance, and the VP Debtors' Focus on Available Collateral Is a Classic Red Herring.

The VP Debtors contend that the Petition raises only a narrow issue of limited importance. In reality, the VP Debtors are concerned only with their own circumstances and ignore the consequences of the decision below on the availability of the form of insurance in question. The concurrence below properly recognized the broader implications and acknowledged that, by denying National Union administrative expense status, the court's decision would "likely spell an end to the availability of extended payment terms for insurance in the bankruptcy setting." Pet. App. 18a.

Once again, the VP Debtors' solution is for an insurer to take more collateral. As noted, however, that position is nonsensical. It is also contrary to the purpose of administrative priority. As acknowledged in *Reading* and subsequent cases, the overriding purpose of administrative priority is to ensure successful reorganizations. *Reading*, 391 U.S. at 475 ("the words 'preserving the estate' include the larger objective . . . of operating the debtor's business with a view to rehabilitating it."); *NLRB v. Bildisco*, 465 U.S. 513, 527-28 (1984). The VP Debtors' proposed solution is contrary to this purpose be-

cause taking more collateral would simply add additional cost.

Absent this Court's intervention, the effect of the decision below is sure to be felt in many business reorganization proceedings due to the undisputed requirement that corporate debtors seeking to reorganize must obtain workers' compensation insurance. Because payments made to injured employees under workers' compensation insurance plans are intended to be a form of wage substitute, they are designed to and generally do extend into the future – well beyond the duration of the typical bankruptcy case. Under such an arrangement, insurers have little control over when bills will be submitted, but debtors are free to (and the VP Debtors did in this case) confirm their plans before payments to injured employees are concluded. Ironically, the VP Debtors inappropriately assert that the timing of subsequent billing is controlled by National Union. Op. 32-33. In reality, however, the timing of bills submitted is dictated by when payments are made to the injured employees, and this problem will repeat itself for all insurers that offer insurance of this kind within the Sixth Circuit unless the decision below is corrected.

CONCLUSION

For the foregoing reasons, the petition for writ of certiorari should be granted.

Respectfully submitted,

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